BRIEF IN SUPPORT OF PETITION.

Opinions Below.

The opinion of the United States Board of Tax Appeals is unreported and appears at R. 15. The opinion of the Circuit Court of Appeals (R. 93-9) was rendered on May 12, 1942, and is as yet unreported.

Jurisdiction.

The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code as amended by the Act of February 13, 1925, 43 Stat. 938; Sec. 347 U. S. Code, Title 28. The judgment of the Circuit Court of Appeals now sought to be reviewed was entered on May 12, 1942.

Statement of the Case.

The principal facts are set forth in the petition at pages 2 to 4.

Specification of Errors.

The Circuit Court of Appeals erred:

1. In holding that the $15,000 received by the petitioner from Hiram Walker & Sons, Incorporated, was "compensation for personal service" within the meaning of Section 22(a) of the Revenue Act of 1936.

2. In adopting and giving weight to a presumption that because petitioner failed to put in evidence the book entries made by Hiram Walker & Sons, Incorporated, "such book entries would show that the payor treated the sum paid the petitioner as compensation."

3. In affirming the decision of the Board of Tax Appeals.

The Statutes Involved.

The statutes and regulations involved are set forth in full in the Appendix, infra, p. 18.

Argument.

I. There is a conflict of decisions in the various Circuit Courts of Appeal on the question here involved that should be resolved by this Court.

The basic question is whether amounts distributed by an employer constitute "compensation for personal service" or "gifts" under the Revenue Acts, when the distributions are made to a departing employee without legal or moral obligation therefor and without expectation of future benefit therefrom. This is not a question of fact, but a "conclusion of law or at least a determination of a mixed question of law and fact." *Bogardus* v. *Commissioner,* 302 U. S. 34, 39 (1937). It turns upon the interpretation accorded the words "compensation for personal service" and "gift". The various circuit courts of appeal are sharply split on the proper limits of these terms. The decisions cannot be distinguished adequately on their facts. The basic thread of absence of present or anticipated consideration, either in form or substance, runs through them all. In addition, each case contains mutually contradictory factors indicating, on the one hand, that the payment is inspired by good will (hence a gift) and, on the other, that the causative factor is past services (hence compensation). Diametrically opposed decisions will continue to issue from different circuit courts on practically identical fact situations until this Court lays down a rule as to the proper interpretation of the statutory terms.

Thus, three Circuit Courts have decided the question in accord with the decisions of the lower Court here. *Walker* v. *Commissioner,* 88 F. (2d) 61 (C. C. A. 1, 1937), involved the same fact situation subsequently passed upon by this Court in *Bogardus* v. *Commissioner, supra,* and set forth in detail, *infra,* pp. 12-15. In the *Walker* case, the First Circuit held that the payments involved constituted com-

pensation taxable to the recipient. The Court (Morton, C. J., dissenting) relied upon *Old Colony Trust Company* v. *Commissioner,* 279 U. S. 716, 730 (1929), for the proposition that an entirely voluntary payment for services is compensation; but added that, in any event, the Board had determined on conflicting evidence that the payments involved were compensation and "* * * its determination was final." (at p. 63) Despite the express disapproval of the *Walker* decision by this Court in the *Bogardus* opinion (302 U. S. 34, 42), the decision in the *Walker* case appears to be considered the law of the First Circuit. The lower Court here cites it for the proposition that payments made "in appreciation of services rendered" constitute a "bonus" and "remuneration" (R. 96-7). Further, the Board of Tax Appeals very recently cited the *Walker* case as representing the views of the First Circuit on the question here involved. *Samuel Poorman, Jr.,* 45 B. T. A. 73, 80 (1941). Thus the *Walker* decision still stands in sharp conflict with the decisions of other circuits, as the First Circuit's position that amounts paid by a former employer without legal or moral consideration and without expectation of future benefit, constitute compensation.

The decision in *Fisher* v. *Commissioner,* 59 F. (2d) 192 (C. C. A. 2, 1932), is to the same effect. There a veteran employee upon resigning his employment was handed his employer's check for $6,000, in addition to payment of all compensation due. At no time in his twenty-four years of service had the employee received from his employer any amounts beyond his regular compensation, nor had the employer ever paid a bonus to any of its officers or employees. Payment of the $6,000 in question was informally approved by the employer's executive committee and there was no other corporate action thereon. The petitioner's superior officer had stated, to the employee prior to the payment, that the employer "would do something for him" on resignation. When made, the payment was charged to

the employer's salary account on its books. Conceding there was no legal duty on the employer to pay the $6,000, the Court, relying heavily on the *Old Colony Trust Company* case, supra, held it to be compensation for past services.

In *Botchford* v. *Commissioner,* 81 Fed. (2d) 914 (1936), the Ninth Circuit held that a payment in excess of all compensation due, made by an employer to its former employee after his resignation, constituted compensation taxable to the latter. This was in the face of testimony of the employer's directors that the payment was intended as a gift. The Court's position was that language in the director's resolution authorizing the payment, which characterized the payment as remuneration, together with the employer's action in claiming an income tax deduction for the payment as "salary", fixed the character of the payment as compensation. Here, too, there was no obligation on the employer or expectation of future benefit.

In conflict with these decisions from the First, Second and Ninth Circuits and the lower Court here are the following decisions of the Third, Fourth and Fifth Circuit Courts of Appeals.

Jones v. *Commissioner,* 31 F. (2d) 755 (C. C. A. 3, 1929) held that payments made from the funds of two liquidating corporations to former employees thereof, were gifts and not taxable income to the recipients. The Board of Tax Appeals had held the payments taxable as compensation for services rendered. The basis of the Circuit Court's decision was that the stockholders of the liquidating corporations made the payments "without obligation on their part * * * in recognition of the past faithful work of the staff * * *" (at p. 756).

In *Cunningham* v. *Commissioner,* 67 F. (2d) 205 (1933), the Third Circuit again passed on the basic question. There, upon the resignation of an employee, the employer paid him $15,000 "* * * in appreciation of Mr. Cunningham's excellent guidance of this Corporation through

times of difficulty and depression * * * as an honorarium * * *" (at p. 205). On the basis that this was a voluntary payment which the employer was under no obligation to pay, the Court held it to be a gift and reversed the Board of Tax Appeals' decision that the payment was compensation for past services.

Hall v. *Commissioner,* 93 F. (2d) 1005 (C. C. A. 4, 1938) and *Simpkinson* v. *Commissioner,* 93 F. (2d) 1015 (C. C. A. 5, 1937) both involved the same fact situation that came before this Court in *Bogardus* v. *Commissioner, supra.* On these facts, which are set forth, infra, p. 12-15, both Courts on the authority of the *Bogardus* decision, reversed the Board of Tax Appeals and held the payments involved to be gifts rather than compensation.

Thus the basic question remains unsettled. The lower Court here and the decisions in accord therewith seemingly hold that any payment by an employer to a former employee is compensation if inspired by the past services of the recipient. The contrary decisions require either a present or future consideration flowing to the employer. This Court should resolve the existing confusion and limit the boundaries of "compensation for personal service" and "gifts" within the meaning of the Revenue Acts.

II. The Court below decided this case in a way in conflict with the applicable decision of this Court, namely, *Bogardus* v. *Commissioner,* 302 U. S. 34 (1937).

In *Bogardus* v. *Commissioner,* 302 U. S. 34 (1937) this Court held that payments to employees of a corporation, made by its former stockholders acting through a successor corporation, "in recognition of the valuable and loyal services" of such employees and made after all compensation due had been fully paid, did not constitute taxable income to the recipients.

The facts in that case were, briefly, these: Universal Oil Products Company was succeeded, as to a part of its

properties, by Unopco Corporation. The former stockholders of Universal became stockholders of Unopco with the same proportionate holdings. The stock of Universal (which presumably continued in existence) was then sold by such stockholders to United Gasoline Corporation. Thereafter, the stockholdeers, acting through their new corporation, Unopco, made substantial payments to certain past and present employees of Universal and Unopco. These payments were variously characterized in resolutions of Unopco's directors and stockholders and in statements by individual stockholders, as a "bonus * * * in recognition of the valuable and loyal services of the employees" (at p. 42) and as a "gift or honorarium" (at p. 43).

This Court stated the question to be "* * * whether a sum of money received by petitioner in January, 1931, was 'compensation' subject to the federal income tax, or a gift exempt therefrom" (p. 35). After referring to the decision below, the Court stated: "The decisions of other courts of appeal upon the question under review are conflicting." Numerous cases were then cited in which, respectively, payments made by an employer to a past or present employee were held to be either "compensation" or a "gift" (at p. 35). The Court then proceeded to clear up the misapprehension previously existing as to whether the terms "compensation" and "gift" as used in the Revenue Acts, were mutually exclusive (at p. 39). The opinion then discussed at length the distinguishing attributes of a gift and compensation in the situation of a payment by an employer to a past or present employee and, it is submitted, established the principle that a payment, made without legal or moral obligation and without expectation of future benefit, is not taxable to the recipient (at pp. 42-43). That the decision established this principle is supported by the following statement from the dissenting

opinion (at pp. 44-45). "A payment received as compensation for services is taxable as income, though made without consideration, and hence for many purposes a gift. *Old Colony Trust Co.* v. *Commissioner,* 279 U. S. 716, 730. To hold, as the prevailing opinion seems to do, that every payment which in any aspect is a gift is perforce not compensation, and hence relieved of any tax, is to work havoc with the law. A large body of decisions, whose provenance is *Old Colony Trust Co.* v. *Commissioner,* would be annulled by such a test (citations). Their teaching makes it plain that the category of 'gift' and 'compensation' are not always mutually exclusive, but at times can overlap."

The court below expressly failed to recognize that the *Bogardus* decision of this Court established the rule that "compensation" and "gift" are mutually exclusive terms and that a payment by an employer is not taxable as compensation, where it bears the aspects of a gift in being made without legal or moral obligation and without expectation of future benefit. Thus the court below stated:

> "In reference to the *Bogardus* case, it should be borne in mind that it is unsafe to classify adjudicated cases upon any complex question of law and to extract from them rules of general application as the reasoning in such cases is often due to their diversities. It is therefore wiser to decide each case upon its own peculiar state of facts as to do otherwise, leads us into the field of abstract reasoning. The *Bogardus* case illustrates the necessity of following this rule. It discusses numerous cases from the circuits and from the Court of Appeals of the District of Columbia, overrules none of them and leaves each as positive authority coextensive with the facts on which the opinion was founded" (R. 98).

The conflict between the decision of the lower court here and the *Bogardus* decision stems from the lower court's express failure to recognize and follow the well considered rule of the latter case. There can be no dispute that here

petitioner received $15,000 without an iota of legal or moral obligation resting on his former employer and without the slightest expectation on the employer's part to derive any future benefit therefrom. Whether, as we assert and the lower court denies, the *Bogardus* case established a principle of general application as the minority therein felt it does, should be decided by this Court upon a review of this case. The implications of the question go beyond the importance of this case to the individual petitioner. Other lower courts undoubtedly will seize upon the above quoted language from the lower court's opinion here, and the confusion sought to be eliminated by this Court when it reviewed the *Bogardus* case on the basis of a then existing conflict will arise anew.

III. The court below in adopting and giving weight to a presumption against the petitioner, without any basis in the record, so far departed from the accepted and usual course of judicial proceedings as to call for an exercise of this Court's power of supervision.

The court below had the power to reach an independent judgment as to whether or not the payment in question was to be characterized as "compensation for personal service" within the meaning of the Revenue Act. *Bogardus* v. *Commissioner*, 302 U. S. 34 (1937); *Helvering* v. *Tex-Penn Oil Company*, 300 U. S. 481 (1937). The lower court exercised this power. After considering "all of the elements to be taken into account in determining whether the present payment was a gift or compensation for past services * * *", the court reached the latter conclusion (R. 98).

In weighing the conflicting facts of record to arrive at this conclusion, the lower court raised and gave weight to an unwarranted presumption. Thus, it stated:

> "The taxpayer having failed to put in evidence the book entries made on the payor's books simultaneously with the payment in question, we presume such entries

> would support the deduction claimed in the payor's income tax return and that such book entries would show that the payor treated the sum paid the petitioner as compensation" (R. 97).

Neither the Commissioner nor the Board had made any determination or finding as to what these book entries, if any, were, nor was any evidence adduced at any stage of the proceedings to show what book entries, if any, were made by Hiram Walker & Sons, Incorporated, or Hiram Walker-Gooderham & Worts, Limited, with respect to this payment.

The lower court in raising a presumption that the book entries, if produced, would have tended to prove one thing rather than another, was simply indulging in speculation. It is submitted that in going outside the Record to presume the existence of this fact, which it then weighed with the facts of record in reaching its decision, the Circuit Court committed reversible error. This Court either should substitute its judgment, based on the record, for that of the lower court or it should remand the case for decision on the record. The proposition is too clear to require citations that where a fact-finding tribunal considers inadmissible evidence, an appellate court will not attempt to weigh the effect of such evidence on the lower court's decision. Here the fact presumed may have had great or little influence on the Circuit Court. Apparently, used to show the intention of the payor, the weight accorded this assumed fact probably was great. Thus the court stated:

> "When the income tax deduction of the payor is tied to *its earlier book entries* on the subject, *the evidence of the deduction is of weight* in determining whether or not the payment was a gift to petitioner" (R. 97-8). (Italics supplied.)

No basis for the lower court's presumption can arise from the petitioner's failure to introduce the books of Hiram Walker & Sons, Incorporated, or Hiram Walker-

Gooderham & Worts, Limited. At the time this case was tried, the petitioner had no connection whatsoever with those companies. He was employed by a principal competitor thereof (R. 18). Clearly, the books in question were in no way under petitioner's control, and it may be doubted that it would have been possible for him to produce them. On the other hand, the respondent had ample power to compel the production of these books. Therefore, there is more basis for assuming that the book entries were unfavorable to respondent than there is for the presumption adopted by the lower court. As respondent's failure to produce these books could not be construed as an "admission" by him as to their contents, *a fortiori*, the lower court's action in adducing evidence in the nature of an "admission" against the petitioner was unfounded.

Conclusion.

It is respectfully submitted that this Court should review the instant case, in order to resolve the conflict of decisions in the several circuit courts as to the proper interpretation of the phrase "compensation for personal service"; in order to correct the lower court's failure to recognize the rule of general application laid down by this court in the *Bogardus* case; to correct the lower court's departure from accepted judicial procedure in presuming and giving weight to a fact not of record, and that the writ should issue as prayed.

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